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TAX AND SUBSTANTIVE ASPECTS OF GIFTS TO MINORS*

Lawrence Newman†

INTRODUCTION

Significant advantages are available to donors who contemplate making gifts to minors.¹ From an income tax standpoint, the child, or a trust for his benefit, is an additional taxpayer with a separate exemption and, generally, is in a lower tax bracket than the donor.² Gifts to a minor may also remove the property from the donor's taxable estate for estate tax purposes.³ Moreover, the gift tax cost will usually be minimal because of the 3,000 dollar annual exclusion, the 30,000 dollar lifetime exemption, and the gift splitting privileges available to married taxpayers.⁴ The gift also has the advantage of retaining the family assets within the family unit.

I
OUTRIGHT GIFT

The donor, aware of these substantial benefits, may decide to make an outright gift of securities, cash, or life insurance. An additional taxpayer will be recognized for income tax purposes, the property will be removed from the donor's estate for estate tax purposes and, since the direct transfer is considered to be a gift of a present interest, it will qualify for the annual gift tax exclusion.⁵ Thus, the outright gift offers income, estate, and gift tax advantages and, in addition, apparent simplicity.

The disadvantages of this form of gift are, however, substantial. Be-

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* This article is based on an address delivered by the author before the East Coast Estate Planning Council in November 1964.
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² Int. Rev. Code of 1954, §§ 151(b), 642(b). A trust which is required to distribute all of its income currently is allowed a deduction of $300. A trust which permits income to be accumulated is allowed a deduction of $100.
³ This discussion does not attempt to consider those general estate tax principles applicable to transfers to adults as well as to minors. Thus, the general assumptions of this article are that the grantor has not made a transfer in contemplation of death, a transfer with a retained life interest, a transfer taking effect at death, or a revocable transfer. See Int. Rev. Code of 1954, §§ 2035-38.
cause of the legal incapacity of minors, the transferred securities cannot be sold and the dividends cannot be reinvested without difficulty. Since minors can disaffirm property transactions, third parties deal at their peril with the property of a minor.\(^6\) The immaturity of the minor may result in his dissipating the property. Finally, if the minor dies before the age of twenty-one, the usual result is an intestacy in which at least some portion of the property may return to the parent, thereby eliminating the income and estate tax advantages of the gift.

Some of these problems can be solved by the appointment of a legal guardian for the minor. This provides great protection for the minor and his property since a bond may be required, the minor's property will be used only with the permission of the court, and periodic accountings will normally be filed. Third parties will not hesitate to deal with the property because the guardian will have the legal capacity to act for the minor.

Unfortunately, the appointment of a legal guardian is not without serious disadvantages. The legal guardianship is expensive and cumbersome.\(^7\) Additionally, if the minor dies before the age of twenty-one, the intestacy possibility once again arises.

Outright gifts to minors would thus appear to involve serious problems to which the appointment of a guardian does not supply a satisfactory solution.

II

Other Forms

Four other forms of gifts to minors effect a more sound combination of the available tax and practical advantages.

The "short term" trust\(^8\) is one in which income is paid to the minor or is accumulated for his benefit for a period of at least ten years, at the end of which the trust terminates and the corpus reverts to the grantor.

The section 2503(c) trust\(^9\) permits the trustee to use the income and corpus "for the benefit of" the child during his minority. All the remaining income and principal must be distributed to the minor when he reaches his majority or, if he dies before attaining the age of twenty-one, the property must be paid to his estate or as he may appoint under a general power of appointment.

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\(^8\) Int. Rev. Code of 1954, § 673(a).

The Uniform Gifts to Minors Acts provide a simple procedure by which an adult can make a gift of securities or cash to a minor, while reserving the managerial powers in a custodian. The custodian’s function is to collect and manage the custodial property and pay over to the minor, or use for his benefit, as much of the property as the custodian deems advisable for the support, maintenance, education, and benefit of the minor. To the extent that the custodial property is not expended for the minor, the custodian must turn it over to the minor on the minor’s attaining the age of twenty-one years or, if the minor dies before achieving his majority, to the estate of the minor.

The section 2503(b) trust allows the income to be paid out to the child during his entire lifetime. The grantor may dispose of the remainder to designated persons other than the minor.

**Income Tax**

Certain general income tax considerations are operative in considering these four types of gifts to minors.

The grantor of a trust is taxable on trust income that may be applied to discharge any of his legal obligations. Where the income may be used to discharge the grantor’s legal obligation of support, however, only income actually so applied or distributed is taxable to the grantor.

A nongrantor trustee who applies trust income to discharge his legal obligation of support is similarly taxed on the income only to the extent that it is actually so applied.

The regulations extend the potential income tax liability even further by providing that “any amount which, pursuant to the terms of a will or trust instrument, is used in full or partial discharge or satisfaction of a legal obligation of any person is included in the gross income of such person . . . .”

The two major potential pitfalls in the income tax area involve payments satisfying a support obligation or a contractual obligation.

In the support situation, tax liability, to the extent of income actually used to satisfy the obligation rather than to income which is available for this purpose, may be imposed on the grantor of the trust, on a nongrantor trustee, and even on a nongrantor who is not a trustee. Whether a particular payment discharges an individual’s support obligation often is a difficult problem to resolve. The regulations state that local

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law determines the extent of a parent's obligation to support a child: "the term 'legal obligation' includes a legal obligation, to support another person if, and only if, the obligation is not affected by the adequacy of the dependent's own resources" and "to the extent that the parent's legal obligation of support, including education, is determined under local law by the family's station in life and by the means of the parent, it is to be determined without consideration of the trust income in question."

The most topical problem in this area is whether payments from trust income for education expenses of a minor constitute the discharge of a parent's obligation to support his child thus making the income taxable to the parent. In New York, this depends on a consideration of the assets, social position, and situation in life of the infant and his parents. In *International Text Book Co. v. Connelly*, an infant, representing that he was twenty-one years of age, entered into a contract pursuant to which he agreed to pay a specified sum to plaintiff as tuition for plaintiff's engineering course. The court overruled the contention that the education expense was a "necessary" and held the infancy to be a defense, stating that the meaning of:

The word "necessaries"... depends on the social position and situation in life of the infant as well as upon his own fortune and that of his parents. What would be necessary in a legal sense for an infant with ample means of his own might not be so for one with no means at all. ...

A proper education is a necessary, but what is a proper education depends on circumstances. A common school education is doubtless necessary in this country, because it is essential to the transaction of business and the adequate discharge of civil and political duties. A classical or professional education, however, has been held not to come within the term. Still, circumstances... may exist where even such an education might properly be found a necessary as a matter of fact.

Various statutes treat education as an element of support. There is nothing in the cases that would prevent expenses for a college education, for example, from being considered as support in a proper situation. In fact, the very existence of a trust created by a parent to provide for

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17 206 N.Y. 188, 99 N.E. 722 (1912).
18 206 N.Y. 188, 99 N.E. 722 (1912).
20 See also Matthews v. Matthews, 14 App. Div. 2d 546, 217 N.Y.S.2d 736 (2d Dep't 1961) ("whether a college education is a necessary... in the light of respondent's pecuniary ability, and whether her present support allowance is sufficient to sustain the cost of such education, constitute questions of fact for the Children's Court to resolve in the first instance"); Samson v. Schoen, 204 Misc. 603, 121 N.Y.S.2d 489 (Dom. Rel. Ct. Queens County 1953) (father's duty of support held not to include the expenses of a college educa-
the education of his child might be a factor indicating that the family's station in life justified the conclusion that the payment of college education expenses was within the parent's obligation of support.

Several solutions to the support problem have been suggested. One of these is to accumulate trust income during minority; this would prevent the income from being taxed to the person obligated to support the minor. If the trust provided that income could only be used for luxury items, the income would be removed from the area of support. If income were distributed currently to the minor and invested for his benefit, it would seem that the income was not being used for the minor's support. Legislative provisions declaring that parents have no duty to provide a college education where a minor has independent means or where trust corpus or income is available for his education would also seem to refute the argument that trust income used for education constitutes a discharge of the parent's support obligation.

22 Ehrlich, supra note 1; Lauritzen, "Super Support Trusts—Or How To Set up a Trust To Pay Income to Minor Children Without Taxing the Income to the Settlor," 1 Tax Counselor's Q., June 1957, p. 1; Miller, supra note 1.


Parents as joint natural guardians—The father and mother shall be the joint natural guardians of their minor children and shall be equally charged with their care, nurture, welfare and education; and they may be sued either jointly or separately for the support of their minor children. To the extent that any such minor child has property or an estate of his or her own, or that there is income or principal of any trust for his or her benefit, which may be used to provide such child with an education in a college, university or private school, such natural guardians shall not be obligated either jointly or separately to provide such an education. The foregoing sentence shall not be deemed to create by implication any obligation to provide such an education where none would otherwise exist.


Reduction of obligation to support person with income from estate or trust—Whenever income from an estate or trust is available for the benefit of a person whose support is the legal obligation of another and such income is actually used for such person's support, the legal obligation of the other to support such person is reduced to the extent that such income is actually used for such person's support.


In the contractual obligation context, the grantor's tax liability is not limited to payments actually made, but extends to all income that may be used to discharge his legal obligations. In *Morrill v. United States* the taxpayer established four ten year trusts to pay the costs of tuition, room, books, and travel for his four children while they were attending colleges and private schools. As each trust terminated, its corpus was to revert to the taxpayer. At two of the schools the taxpayer had signed a contract under which he agreed to be responsible for the payment of the bills. The court held that the amount paid from the trusts was includible in the taxpayer's income since it was used to satisfy a legal obligation of the taxpayer. The grantor in this case was taxed both on the two express contracts and on the implied obligations to pay the children's bills at the other schools. It is not unusual for parents to sign a contract with a school pursuant to which they agree to be responsible for the payment of their child's tuition fee. The danger is that the government may argue that payment of trust income, where required by contract, constitutes the discharge of a contractual obligation rather than payment for "support." If this argument succeeded, the grantor could be taxed on the entire trust income whether or not it was actually used for tuition.


The State of Louisiana, influenced by the Roman law doctrine of usufruct as developed by the Napoleonic Code, provides as follows in La. Civ. Code arts. 223-224 (Slovenko 1961):

> Fathers and mothers shall have, during marriage, the enjoyment of the estate of their children until their majority or emancipation ... The obligations resulting from this enjoyment shall be:

> 1. To support, maintain and to educate their children according to their situation in life.

> 2. To support, maintain and to educate their children according to their situation in life.

In the case of Succession of Fontano, 196 La. 775, 792-3, 200 So. 142, 148 (1941), the court stated:

> When children have property from which a sufficient income may be derived to provide for their subsistence and education, the natural obligation of their father ceases, after the dissolution of the marriage; and ... then their expenses should be provided for out of the revenues of their property, pro tanto, at least if insufficient.

24 64-1 U.S. Tax Cas. § 9463 (D. Me.).

25 The District Court's opinion in the Morrill case contained the following footnote:

> The Commissioner initially based his assessment on Section 677(b). The Government later shifted its ground for asserting taxability to Section 677(a). During legal argument before the Court, counsel for the Government and for the taxpayers conceded that Section 677(b) has no application to the facts of this case. In this they were correct because Subsection (b) merely limits the tax, imposed by Subsection (a), on trust income which may be applied for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, to that portion of the trust income which is so applied. Here the Government has not attempted to tax that part of the trust income which was not used to pay the school and college bills in issue. Congress
Estate Tax

Certain general estate tax principles arise in considering short term trusts, section 2503(c) trusts, transfers under the Uniform Gifts to Minors Acts, and section 2503(b) trusts.

If the grantor is one of the trustees and has a power to direct the use of the trust income to support his dependents, the trust property is includible in his estate as a retained right to possession or enjoyment of income. Similarly, where a grantor who is also a trustee retains the right to accelerate payments of corpus to the beneficiary, the trust property will be included in the grantor's estate if he dies during the term of the trust without having exercised this power.

In *State St. Trust Co. v. United States,* the grantor as co-trustee had the power: (1) to exchange trust property for other property without regard to the value of the respective properties; (2) to invest in nonlegals or nonincome producing properties; and (3) to allocate stock dividends and capital gains to principal or income. The court held that the decedent as co-trustee had reserved such broad powers that he could shift the economic benefits between the life tenant and remainderman. The trust property was therefore includible in his estate since he had a right to designate those persons who would possess or enjoy income. The *State Street* doctrine of retained administrative control appears, however, to have been restricted to its particular facts by the courts.

Gift Tax

Gifts to a section 2503(c) trust and transfers under the Uniform Gifts to Minors Acts qualify for the gift tax annual exclusion. Certain general gift tax exclusion considerations apply to short term trusts and to section 2503(b) trusts.

The income interest of a trust requiring a mandatory distribution of income qualifies for the annual exclusion. If the trust provides for a mandatory distribution of income among several beneficiaries, however, the interest of the donees is not considered a present interest and thus does not qualify for the annual exclusion. If the trust directs a

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enacted what is now Subsection (b), 58 Stat. 51 (1944), to change the law established by the holding in Helvering v. Stuart, 317 U.S. 154 (1942) [that income which may be used to discharge the grantor's legal obligation of support is taxable to him]... Id. at 92,240 n.2.
28 263 F.2d 635 (1st Cir. 1959).
30 Sensenbrenner v. Commissioner, 134 F.2d 883 (7th Cir. 1943); Fisher v. Commissioner, 132 F.2d 383 (9th Cir. 1942).
mandatory distribution of income, but permits discretionary principal invasion in favor of the income beneficiary, the annual exclusion is available. With limited exceptions, if the trust provides for a discretionary accumulation of income, the annual exclusion is not available. A trust which has a mandatory accumulation provision does not qualify for the annual exclusion.

III

Short Term Trust

The "short term trust" may be described for our purposes as one under which the income is payable or accumulated for the benefit of a child for at least a ten year period, at the end of which it terminates and the trust property reverts to the grantor. For income tax purposes a new taxpayer has been created and the trust income will therefore not be taxed to the grantor, but will instead be taxed to the trust if accumulated, or to the income beneficiary if paid to him. There is little estate tax advantage derived from this type of transfer since the grantor has retained a substantial reversionary interest. If the grantor dies during the term of the trust, the corpus of the trust, less the value of the outstanding income interest, is included in his estate for estate tax purposes. A gift tax would be payable on the right to income for the ten year period. The annual exclusion would be available if the trust provided that all income was currently distributable to the beneficiary, but not if the income could be accumulated in the discretion of the trustee.

The "short term trust" is most advantageous as an income shifting device for the grantor in a high income tax bracket whose capital assets do not warrant a permanent transfer of property. Moreover, successor trustees may be designated by the grantor and the trust instrument may grant the trustees broad investment discretion. On the other hand, the grantor has only made a temporary transfer of his property and the cost of retaining this substantial future interest is that the reversionary interest is included in the grantor's estate for estate tax purposes.

32 The exclusion is expressly available under § 2503(b) of the 1954 Internal Revenue Code. Prior to 1954, the exclusion would have been denied on the ground that the income interest of the beneficiary was incapable of valuation. See, e.g., Jennie Brody, 19 T.C. 126 (1952); Sylvia H. Evans, 17 T.C. 206 (1951), aff'd, 198 F.2d 435 (3d Cir. 1952).

33 The exclusion has been granted for the income interest of a discretionary accumulation trust where there is some indication from the trust or surrounding circumstances that a steady flow of income will occur. See, e.g., Elise Mck. Morgan, 42 P-H Tax Ct. Rep. & Mem. Dec. 42.85 (Sept. 21, 1964) (discretionary payments of income during the minority of a retarded minor qualified for annual exclusion).


35 Ryerson v. United States, 312 U.S. 405 (1941); United States v. Pelzer, 312 U.S. 399 (1941).
A danger for the donor of the short term trust lies in the capital gains area. Any capital gains realized by the trust will be taxed to the donor in the year realized even though he does not currently receive the sales proceeds out of which to pay the capital gains tax. If an attempt is made to avoid the capital gains tax liability of the donor by providing that capital gains are distributable to the income beneficiaries, the entire gift, rather than only the income interest, may be subjected to a gift tax. The possibility that principal, in the form of realized capital gains, will not revert to the grantor might cause the Internal Revenue Service to take the position that the reversionary interest is incapable of being valued and that the entire principal constitutes a gift.

IV

Section 2503(c)

The section 2503(c) trust is a form of transfer which permits the property and income therefrom to be used for the benefit of the minor. To the extent that the property is not used for the minor, it must be distributed to him when he reaches the age of twenty-one. If the minor dies before this age, the property must be payable to his estate or as he may appoint under a general power of appointment. The regulations provide that the power of appointment may be exercisable by the donee by will or during his lifetime and that the minor’s incapacity, under local law, to exercise such a power is of no tax significance. Thus, under the section 2503(c) trust, a minor can be given a general testamentary power of appointment and provision can be made by the grantor for a gift over in default of the exercise of this power. Section 2503(c) represents the legislative resolution of the confusion as to whether gifts in trust for the

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37 Rev. Rul. 60-385, 1960-2 Cum. Bull. 77, held that where a trust instrument provides that the principal of a trust may be invested in stock of regulated investment companies and that capital gains dividends are to be treated as income and paid to the life tenant, the charitable remainder interest is incapable of valuation and no deduction is allowed. A private letter ruling has apparently applied this reasoning to the short term trust reversionary interest situation. See "Shop Talk," 12 J. Taxation 382 (1960).
39 In Kieckhefer v. Commissioner, 189 F.2d 118 (7th Cir. 1951), and in Stifel v. Commissioner, 197 F.2d 107 (2d Cir. 1952), the trustees were empowered to pay or apply income to, or for the benefit of, the minor beneficiaries and to accumulate any amounts not so paid or applied. The beneficiaries, or their guardians, could request that the accumulated income and corpus be distributed to them. In neither of the cases was a guardian actually appointed. The court in Kieckhefer decided that the annual gift tax exclusion was available since present rights had been created in the income and corpus despite the disability of the minor. The Stifel court reached a contrary result and denied the exclusion on the ground that, as no guardian had actually been appointed, the minor did not possess a sufficient present interest to entitle the settlor to the annual exclusion. The Stifel case view was adopted by the Internal Revenue Service in cases under the 1939 Code. The appointment of a guardian was the determining factor. Rev. Rul. 54-91, 1954-1 Cum. Bull. 207.
benefit of minors qualify for the annual exclusion. It provides in relevant part that:

No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property . . . if the property and the income therefrom—

(1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and
(2) will to the extent not so expended—

(A) pass to the donee on his attaining the age of 21 years, and
(B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment . . . .

The effect of section 2503(c) is that gifts made in compliance with the statute qualify for the annual gift tax exclusion even though the trustee has the discretion to accumulate income for the minor and is not required to pay the income currently to the minor. Further, a new taxpayer is created for income tax purposes by this form of transfer and the property transferred to the trust does not fall into the grantor’s estate.

The grantor is afforded the flexibility of being able to designate successor trustees and to permit broad investment authority to be exercised by the trustees. Further, the donor, by providing for a taker in default of the minor’s exercise of a power of appointment, can keep the property out of the minor’s estate if the minor dies before the age of twenty-one. The fact that local law may not permit the minor to exercise his general testamentary power of appointment—for example, where he is under the age required for the valid execution of a will—does not prevent the grantor from effectively designating a taker in default. The disadvantage of this form of transfer is that the property must be given outright to the minor at the age of twenty-one. Where substantial property is involved, a grantor may prefer that certain restraints on the beneficiary’s control remain until the beneficiary is older than twenty-one.

It should be recognized that the availability of the gift tax exclusion depends on strict compliance with the statutory provisions. If the minor dies before the age of twenty-one, the statute requires that the property pass to his estate or as he appoints under a general power of appointment. A trust which creates a remainder over to the descendants of the beneficiary if he dies before the age of twenty-one does not satisfy the requirements of the statute.\(^{40}\) The statute further demands that the property be given outright to the minor when he attains the age of twenty-one. A trust which provided that it would automatically be extended after the

\(^{40}\) Bonnie M. Heath, 34 T.C. 587 (1960).
beneficiary reached twenty-one unless he elected to terminate would not qualify for section 2503(c) treatment.\(^4\)

An interesting line of recent cases suggests the possibility of qualifying a portion of the income interest for the annual exclusion even where the trust corpus is not distributed to the minor when he reaches twenty-one. In Jacob Konner\(^4\) the court held that where the income of a short term trust was required to be paid to a section 2503(c) trust, the income interest of the short term trust constituted a present interest for purposes of the gift tax exclusion. In Arlean I. Herr\(^4\) the trust was to continue until the minor beneficiary reached the age of thirty. During minority, the trustees could distribute income to the beneficiary or accumulate it for his benefit, but when the beneficiary attained the age of twenty-one, all accumulated income was required to be paid to him. After the beneficiary attained majority, the trust income was directed to be paid to him currently. The court, distinguishing the income interest during minority from the balance of the income interest and from the interest in principal, held that the gift of the income interest during minority qualified for the annual exclusion.

Although the Internal Revenue Service has not acquiesced in the Court's determination of the Herr case, the attractive possibility exists of qualifying a substantial portion of a trust transfer for the annual exclusion without requiring the entire principal to be paid to the minor when he reaches twenty-one and without distributing income currently to the beneficiary during minority.\(^4\)

The section 2503(c) trust is a flexible and effective device for transfers to a minor if the grantor is not averse to having the trust corpus and accumulated income go outright to the minor when he reaches twenty-one. The estate planning value of the section 2503(c) trust may be enhanced when combined with a Konner case pour-over from a short term trust, thus qualifying the entire income interest of the short term trust for the annual exclusion while preserving the grantor's reversionary interest in the corpus. Herr may permit the variation that the annual exclusion may be preserved for a large portion of the income interest even if the trust provisions do not require that the entire income interest be distributed to the minor when he becomes twenty-one.

\(^{42}\) 35 T.C. 727 (1961).
\(^{43}\) 35 T.C. 732 (1961), aff'd, 303 F.2d 780 (3d Cir. 1962).
\(^{44}\) See, e.g., Josephine N. Thebaut, 23 CCH Tax Ct. Mem. 603 (1964) (income interest qualified for the annual exclusion even though the trustee did not have the power to distribute corpus during the term of the trust); Rollman v. United States, 342 F.2d 62 (Ct. Cl. 1965).
Under the Uniform Gifts to Minors Acts, outright gifts of legal title to securities and money can be vested in a minor while management rests in the custodian. The custodian has the discretion to pay over as much of the custodial property as he deems advisable for the support, education, maintenance, and benefit of the minor. To the extent that the custodial property is not so distributed, it must be paid to the minor on his attaining the age of twenty-one or to his estate if he dies before that time. This form of transfer does not permit the donor to provide for a remainder over in default of the exercise of a power of appointment by the minor.

A gift under the Uniform Gifts to Minors Acts qualifies for the annual gift tax exclusion. In 1956, the Treasury Department Tax Rulings Division stated that, under section 2503(c), a gift of property to a minor qualified for the annual exclusion if the income and property could be expended by or for the benefit of the minor prior to his attaining the age of twenty-one, the balance passing to the minor when he reached twenty-one, or in the event of his prior death, to his estate or as he might appoint by deed or will. It was noted that the language of the Uniform Gifts to Minors Acts was substantially the same as that of section 2503(c) of the 1954 Code and that under the Gifts to Minors Acts the minor is vested with full legal title to the securities. The ruling then provided that:

In view of the foregoing, it is held that the transfer by the donor of the shares of stock of Public Service Company of Colorado . . . was completed for Federal gift tax purposes on the date the shares were registered on the books of the corporation in the name of the donor as custodian for his minor daughter. It is also held that the transfer of the shares in question represents a gift of a present interest in property within the meaning of Section 2503(c) of the 1954 Code.

For income tax purposes, this form of gift provides an additional taxpayer. The Internal Revenue Service has analogized the Uniform Gifts to Minors Acts transfers to transfers in trust, holding that income derived from property transferred under the custodian statutes which

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is used to discharge, in whole or in part, a legal obligation of any person to support a minor is, to the extent so used, taxable to the adult.\textsuperscript{40}

The federal estate tax consequences of a gift under the custodian statutes were determined in 1957. Rev. Rul. 366, 1957-2 Cum. Bull. 618 states that when a donor transfers property to himself as trustee and retains the right to pay the income and the principal to a designated beneficiary or the right to withhold enjoyment until the beneficiary reaches a certain age, the value of the property is includible in the donor’s estate under section 2038(a)(1) of the Internal Revenue Code of 1954 because it constitutes a transfer with a retained power to alter, amend, revoke, or terminate. The ruling then indicates that the donor who transfers property to himself as custodian for a minor is in the same position and concludes that “in view of the foregoing, it is held that the value of property transferred by a donor to himself as custodian for a minor donee . . . is includible in the donor's gross estate for Federal estate tax purposes in the event of his death while acting as custodian and before the donee attains the age of 21 years.”\textsuperscript{50} In those situations where the donor is not the custodian, the transferred property is not within his estate.

This form of transfer thus provides income tax, estate tax, and gift tax exclusion advantages. In addition, it is a simple and convenient method of transferring property to the minor which does not require a formal trust agreement or the filing of fiduciary returns.

Transfers under the Uniform Gifts to Minors Acts do, however, present disadvantages. The property must be given outright to the minor at the age of twenty-one. Under most Uniform Gifts to Minors Acts, only transfers of money and securities are permitted.\textsuperscript{51} Where substantial assets are


\textsuperscript{50} Rev. Rul. 57-366, 1957-2 Cum. Bull. 618, 619. See also Estate of Jack F. Chrysler, 44 P-H Tax Ct. Rep. & Mem. Dec. ¶ 44.4 (April 17, 1965). Many of the states had originally enacted the Model Act which was applicable only to gifts of securities. The Uniform Act extended the application of the custodian statute to gifts of money as well as securities and is today the statute in effect in all of the states except Alaska. The question raised was whether the tax rulings which had involved the Model Act statutes covered the Uniform Acts as well. In 1959, the Internal Revenue Service, in Rev. Rul. 59-357, 1959-2 Cum. Bull. 212, stated that the variations between the Model Act and the Uniform Act did not warrant any departure from the previous rulings. Legislation has been introduced, thus far unsuccessfully, to remove the custodial property from the donor-custodian's estate if he dies before the minor reaches the age of twenty-one.

\textsuperscript{51} The Alaska statute allows only gifts of securities. Gifts of life insurance are permitted by the District of Columbia and fourteen states: California, Connecticut, Illinois, Kentucky,
involved, the donor may prefer an arrangement under which the property would not be distributed until the minor is older than twenty-one. Successor custodian arrangements are cumbersome. For example, at present, a successor custodian cannot be designated in the original transfer and, if the custodian dies, court proceedings may be required for the appointment of a successor. The statutes restrict the investment powers of the custodian by providing that, although the custodian may retain any securities originally given, he may reinvest only in such securities as would be purchased by a prudent man of discretion and intelligence who is seeking a reasonable income and the preservation of his capital. Finally, if the minor dies before the age of twenty-one, the property will pass through the minor's estate.

A danger in the custodian statute transfer is that the statute requires the custodian who expends funds for the minor to use these funds for the support, maintenance, education, and benefit of the beneficiary. Every expenditure, therefore, runs the risk of being deemed part of the settlor's taxable income on the ground that it discharges a portion of the grantor's legal obligation of support.

It would thus seem that the principal value of Uniform Gifts to Minors Acts transfers is in situations involving small gifts of securities or cash to minors.

VI

Section 2503(b)

The section 2503(b) trust is a form of transfer under which income is payable currently to a minor. The practical advantages are that the trust need not terminate when the beneficiary reaches the age of twenty-one, corpus may be invaded for the benefit of the beneficiary during the trust term, and the grantor can provide for a gift over on the death of the beneficiary. Additionally, the section 2503(b) trust affords flexibility in successor fiduciary arrangements and in the investment powers which may be granted to the trustees.

For income tax purposes, a new taxpayer has been created. The prop-

Massachusetts, Michigan, Missouri, Nebraska, New Hampshire, New Jersey, North Carolina, Ohio, Tennessee, and Wisconsin.

Legislation is now being drafted which would permit the original custodian, without resigning, to designate a successor custodian. Under the present law, if the person designated as custodian dies, the legal guardian of the minor becomes successor custodian. If the minor has no guardian, application must be made to the court for the appointment of a successor custodian. The proposed legislation would provide that, if the custodian has not designated a successor custodian, a minor over fourteen years of age could designate the successor custodian himself. Application to the court for the appointment of a successor custodian would then be necessary only in the absence of both a designation by the original custodian and an effective designation by the minor.
erty has been removed from the donor's taxable estate. The actuarial value of the income interest qualifies for the annual gift tax exclusion as a gift of a present interest.

The section 2503(b) transfer is most advantageous in connection with a program of transfers to minors. Thus, a husband and wife could, during the minority of a child, give approximately $150,000 in gifts tax free and still each retain $17,000 of their lifetime exemption.53

The major disadvantage of this arrangement, however, is the danger of unwise use of the income by the minor.

CONCLUSION

Outright gifts to minors involve many disadvantages which are not remedied sufficiently by a guardianship arrangement.

The short term trust is a valuable income tax saving device which is used to maximum advantage by the high income tax bracket grantor whose estate tax situation does not justify irrevocable transfers.

The section 2503(c) transfer offers the flexibility of the trust arrangement, but is only suitable where there is no reluctance to having the trust assets distributed to the beneficiary when he attains the age of twenty-one.

The custodian statute transfer is most valuable in situations involving relatively small transfers of securities or cash.

The section 2503(b) trust is of significance as part of a substantial program of gifts to minors.

While there are both advantages and disadvantages present in the various forms of transfers to minors, these techniques provide a wide range of potential estate planning benefits.

53 The exclusion is not available for that portion of the gift which represents the value of the remainder interest. See Rogers, Forbes & Smith, "Recent Changes in the Rules for Gifts to Minors (How the Trouble Has Been Cleared up)," 17 U. Pitt. L. Rev. 585 (1956).